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Of Castles and Kings: A Perspective for Property Tax Reform

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ARTICLES

OF CASTLES AND KINGS: A PERSPECTIVE FOR PROPERTY TAX REFORM

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I. INTRODUCTION

Most people would quickly agree with Benjamin Franklin's often quoted admonition that "in this world nothing can be said to be certain but death and taxes."[1] Montana continues to grapple with this disagreeable certainty in the midst of uncertain economic times and shortfalls in government revenue. Difficult choices have become a necessity.[2] The Montana economy suffered a dramatic downturn during the 1980s, encompassing all of the state's major industries.[3] Despite such economic difficulties, or perhaps because of them, Montana voters have demanded property tax relief.[4] Montana taxpayers have paid among the highest property taxes in the United States.[5] The 1986 enactment of an initiative strictly limiting property tax collections,[6] and the closer-than-anticipated rejection of another that would have abolished property taxes entirely,[7] manifested the voters' desire for property tax reform. In addition to this

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1. 10 A. SMYTH, WRITINGS OF BENJAMIN FRANKLIN 69 (1910).

2. *See Tax Reform Takes Center Stage at '89 Legislature: Money Greases Wheels of Montana Government*, Missoulian, Dec. 26, 1988, at 1, col. 4. Perhaps the most dramatic example in recent years occurred in 1986, when an economic downturn caused revenue to fall short of expenditures. Governor Schwinden called a special session of the legislature to bring the budget back into balance. Senate Journal Special Session III of the 49th Legislature of the State of Montana, at 2 (1986).

3. B. BEATTIE & D. YOUNG, MONTANA TAXATION AND EXPENDITURES: ISSUES AND OPTIONS 3 (1988). Professors Beattie and Young teach in the departments of Agricultural Economics and Economics at Montana State University. The study cited here was published as a monograph by the Burton K. Wheeler Center at Montana State University. *See also* MONT. BUS. Q., Winter, 1988 at 16 (published by the Bureau of Business and Economic Research at the University of Montana) (providing a summary of the study).

4. *See infra* text accompanying notes 94-115.

5. In 1987, Montana ranked tenth in the nation in property tax collections per capita, and fourth in property tax collections per $1,000 of personal income. CAL. TAXPAYERS' ASS'N, *State and Local Tax Collections—1987*, CAL-TAX NEWS, Jan. 15, 1989, at 4 [hereinafter CAL-TAX NEWS]. In 1986, Montana levied the ninth highest property taxes of the fifty states, including both state and local taxes. BEATTIE & YOUNG, *supra* note 3, at 37. *See also* REVENUE AND OVERSIGHT COMMITTEE, COMPARING INDIVIDUAL TAX BURDENS IN THE FIFTY STATES, 46th Montana Legislature, table I, at 4 (1978) [hereinafter COMPARING TAX BURDENS]. The committee reached this conclusion by comparing property taxes levied per $1,000 of personal income. The committee noted that such a comparison may be suspect; property taxes by their very nature "do not correlate with income." *Id.* at 3. Even so, disproportionately high taxes in comparison to income strongly suggest that taxes may consume an inordinately large portion of individual income.

6. Initiative 105 limited property taxes to 1986 levels, but gave the legislature the option of instituting full scale property tax reform. Initiative 105, §§ 2, 3 *reprinted in* SECRETARY OF STATE, 1986 MONTANA VOTER INFORMATION PAMPHLET at 23 [hereinafter 1986 VOTER PAMPHLET]. The voters passed Initiative 105 by a 10% margin. SECRETARY OF STATE, 1986 OFFICIAL CANVASS [hereinafter 1986 CANVASS].

7. Constitutional Initiative 27 would have enacted a constitutional prohibition of all real and personal property taxes. Constitutional Initiative 27, § 2, 1986 VOTER PAMPHLET, *supra* note 6, at 16. The voters rejected that initiative by a vote of 56% against to 44% in favor. 1986 CANVASS, *supra* note 6.

apparent voter dissatisfaction, the Montana Supreme Court recently invalidated the state's school funding system.[8] These circumstances necessitate a serious consideration of property tax reform.

As this article goes to press, the Legislature and Governor Stephens prepare for a special session to consider reforms to Montana's revenue structure.[9] This article presents an argument for comprehensive revision of Montana's property tax system, with emphasis on protecting the interests of taxpayers. This article does not proceed, however, from a perception that Montana's overall tax burden is excessive.[10] Nor does it take a position on the ongoing sales tax controversy. To the extent that government may seek to increase revenue in other ways to compensate for the loss of property tax revenue, policies should assure that property tax reform is not circumvented through overly broad authorizations for new revenue. The fundamental thesis of this analysis is that tax reform can succeed only if undertaken in full consideration of the pitfalls which can frustrate reform. This article therefore directs the attention of policy makers to California's successes and failures in attempting property tax reform. Simply lowering tax rates will not suffice to guarantee the success of tax reform. Policy makers must also consider the amount of revenue the government should collect, the revenue sources to prefer, and the avoidance of possible circumventions of limitations on the property tax.

This article begins by presenting the fundamentals of Montana's property tax system and its current need for reform. It then explores the results of California's attempts at property tax reform. This article concludes with suggestions for Montana policy makers in dealing with the pitfalls that may arise in reforming the property tax system and in making their policy choices effective.

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8. Helena Elementary School Dist. No. 1 v. State, ___ Mont. ___, 769 P.2d 684 (1989).

9. *Governor's Call to Convene the Montana Legislature into Special Session*, May 18, 1989 [hereinafter *Governor's Call*] (the *Governor's Call* will be reprinted in the journals of each house following the special session). This article addresses five of the seven specific revenue issues to which the Governor limited the special session. Those seven issues include the following: equalizing school funding; academic and fiscal accountability; reducing and reforming income and property taxes; constitutional amendments to limit the growth of state spending and limit increases in statewide sales taxes; sources to replace property taxes in school funding; appropriation and authorization of school funding; and state taxation of pensions.

10. Montana ranks twentieth among the fifty states in state and local revenues per capita, and twenty-ninth in total taxes paid per capita. However, Montana ranks higher in terms of state revenue as a percentage of personal income. BEATTIE & YOUNG, *supra* note 3, at 37. Montana's lofty ranking when revenue is compared to personal income probably results from Montana's abundance of natural resources, "which adds more to our tax capacity than to personal income." *Id.* at 16. Even the conclusion that Montana collects a large amount of tax in comparison to personal income may be challenged by another study, which indicates that Montana ranks only twenty-second. CAL-TAX NEWS, *supra* note 5, at 5 (citing statistics compiled by the U.S. Dept. of Commerce, Bureau of the Census). However, Montana's tax burdens still tend to be greater than that of all of its neighboring states, except Wyoming. BEATTIE & YOUNG, *supra* note 3, at 11.

II. MONTANA'S PROPERTY TAX SYSTEM

A. Background

The property tax has been called "Montana's main revenue source."[11] Montana has historically relied more heavily upon the property tax than upon any other source of revenue. In recent years, property tax collections have totaled well over $500 million dollars per year,[12] while the next largest revenue source, the income tax, has generated around $230 million.[13]

The property tax ranks as one of the most ancient forms of taxation. One authority has traced its lineage as far back as the records of the Old Testament, which indicate that the Pharaohs levied a form of property tax.[14] The Romans also levied a property tax, as did the rulers of England both before and after the Norman Conquest.[15] One of the first acts of William the Conqueror upon ascending the English throne was to order a survey of his lands for the purpose of property assessment.[16] Even "[t]he legendary battles of Robin Hood with the Sheriff of Nottingham were more over the collection of taxes than the administration of justice."[17]

In Montana, the first Territorial Legislature enacted the state's earliest property tax in 1864.[18] Substantial resistance to that first tax can be inferred from the fact that tax collectors received less than thirty percent of the tax due. Many counties levied the tax only at a far lower rate than that set by the Legislature. Three counties, Beaverhead, Chouteau, and Meagher, did not even levy a property tax.[19]

Montana's 1889 constitution contained particularly rigid provisions dealing with property taxes.[20] Like most state constitutions enacted in that period, its stringent limits more resembled a legislative code than a set of fundamental guiding principles.[21] For example, the rigidity of this

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11. *Argument Against Constitutional Initiative 27*, 1986 VOTER PAMPHLET, *supra* note 6, at 7. Authors of that argument included state representatives Gene Donaldson and J. Melvin Williams, University of Montana Professor Thomas Payne, and Ardi Aiken and Eric Feaver. *Id.*

12. MONTANA DEPARTMENT OF REVENUE, 1986-88 BIENNIAL REPORT 135 (1988) [hereinafter BIENNIAL REPORT].

13. *Id.* at 4, 5.

14. 1 K. EHRMAN & S. FLAVIN, TAXING CALIFORNIA PROPERTY § 1:02 (3d ed. 1988).

15. *Id.*

16. *Id.*

17. *Id.*

18. SUBCOMMITTEE ON TAXATION, MONTANA'S PROPERTY TAXES: ASSESSMENT AND CLASSIFICATION, 45th Montana Legislature, at 7 (1976).

19. *Id.* These collection problems continued for some time, despite efforts by the territorial legislature to encourage compliance. *Id.*

20. Comment, *Revenue and Taxation in the Montana Constitution: Present and Proposed*, 33 MONT. L. REV. 126, 126 (1973) (authored by P. Bruce Harper) [hereinafter *Revenue and Taxation*].

21. WE THE PEOPLE OF MONTANA . . . , 5-6 (J. Lopach ed. 1983) [hereinafter WE THE PEOPLE]. This treatise includes contributions by Professors James J. Lopach, Thomas Payne, Ellis Waldron, and Margery Brown of the University of Montana, and Professors

document prevented the legislature from dealing effectively with the problems of property owners who lost their land during the Depression due to delinquent taxes.[22] A large body of case law developed to define the strict limits within which the legislature could act in setting tax policy.[23]

Montana adopted a new constitution in 1972 to replace the outdated and restrictive original.[24] With regard to property taxes, the constitution now provides simply, "The state shall appraise, assess, and equalize the valuation of all property which is to be taxed *in the manner provided by law.*"[25] The constitution therefore leaves a virtually blank slate on which to chart the state's property tax policy.

B. Calculation of Property Taxes

The current property tax system operates on a three-step basis. These three steps are assessment, computation of taxable value, and application of the mill levy to arrive at the amount of tax due.[26] An understanding of each step is essential to any meaningful attempt at reform.

1. Property Tax Assessment

The Department of Revenue carries out the first step in the process by assessing all taxable property at 100% of its market value.[27] State law defines market value as "the value at which property would change hands between a willing buyer and a willing seller . . . ."[28] County assessors bear the responsibility for locating all taxable property and providing the Department of Revenue with all the information required for assessment.[29]

Implicit in the market value concept is the policy of basing assessments on the highest and best use to which the land might be put, rather than on the actual present use. The price a willing buyer will readily pay depends more on what he or she *could* do with the property than with the current use.[30] The legislature created an exception to this principle by enacting statutes mandating that assessments of agricultural land be

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Lauren S. McKinsey and Jerry W. Calvert of Montana State University.

22. *See generally*, State *ex rel* Kain v. Fischl, 94 Mont. 92, 98-99, 20 P.2d 1057, 1060 (1933).

23. *Revenue and Taxation*, *supra* note 20, at 128-34.

24. *See*, WE THE PEOPLE, *supra* note 21, at 6-12 for a discussion of the causes and circumstances of the replacement of the 1889 constitution.

25. MONT. CONST. art. VIII, § 3 (emphasis added).

26. Procedures for levy of the property tax are set forth in Title 15 of the Montana Code Annotated (1987). Additional procedures relative to counties and municipalities are contained in Title 7, Chapter 6, parts 25 and 44 of the Montana Code Annotated (1987).

27. MONT. CODE ANN. § 15-8-111 (1987).

28. MONT. CODE ANN. § 15-8-111(2)(a) (1987).

29. MONT. CODE ANN. § 15-8-102(1) (1987).

30. *See* Goetz, *Recent Developments in Montana Land Use Law*, 38 MONT. L. REV. 97, 122 (1977).

based solely on its value for agriculture.[31] This addresses the problem of owners of agricultural land whose property lies in the path of potential development but who wish to forgo the lure of development dollars to continue farming or ranching. Property taxes thereby become a neutral factor in the decision to sell to a developer.[32]

2. *Calculation of Taxable Value*

The second step consists of calculating the taxable value by multiplying the assessed value by the tax rate applicable to a particular classification of property.[33] The legislature has enacted differing rates of taxation for property, depending upon its character and use. Montana statutes divide property into twenty classifications, each with its own tax rate.[34] Taking as an example a residential property with an assessed value of

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31. MONT. CODE ANN. §§ 15-7-201 to -213 (1987). The Montana Code Annotated currently includes two statutes numbered as § 15-7-201. One applies to the 1986 land valuation schedules, and terminates January 1, 1991. The other applies to the 1991 land valuation schedules. This system effectuates a transition to taxing agricultural land based upon its productive capacity, as mandated by MONT. CODE ANN. § 15-6-133 (1987). *See* MONT. CODE ANN. § 15-7-201(3), (4) (1987) (second statute).

32. Goetz, *supra* note 30, at 124.

33. MONT. CODE ANN. § 15-1-101(1)(P)(1987).

34. Montana's current property classifications include the following:

Class. No.	Brief Description	Tax Rate
1	Net proceeds of mines, except coal or metal	100%
2	Net proceeds of coal and metal mines	3 to 45%
3	Agricultural land	Variable
4	Most residential and commercial real estate	3.86%
5	Some cooperative rural electric and telephone equipment, pollution control devices, new industrial property, research equipment, electrolytic reduction facitlites	3%
6	Livestock and agricultural products	4%
7	Some cooperative rural electric and telephone equipment, electric and gas utility equipment, some tools	8%
8	Agricultural and mining equipment, some equipment and trucks	11%
9	Commercial personalty not in other classes	13%
10	Radio and TV equipment, coal and ore haulers, theatre projectors and sound equipment	16%
11	Most utilities	12%
12	Trailers and mobile homes used as a residence	3.86%
13	Timberland	Variable
14	Improvements to agricultural property	80% of the class four rate
15	Railroad transportation property	Variable
16	Harness, saddlery, and tack equipment	11%
17	Airline transportation property	Variable
18	Nonproductive patented mining claims	30%
19	Non productive small real estate parcels	2%
20	Some agricultural and timber processing equipment	3.86%

$100,000, and applying the applicable tax rate of 3.86%,[35] yields a taxable value of $3,860.

3. *Mill Levies and Calculation of Tax Due*

The final step is to calculate the tax due by applying the mill levy for a particular year. A "mill" is one tenth of one cent,[36] and is generally expressed in terms of mills per dollar of taxable valuation.[37] Both state and local governments impose mill levies, and a multitude of separate levies combine to produce the ultimate tax liability on a particular property. State law contains many provisions for individual levies, and those statutes usually include an upper limit on the number of mills the taxing entity may levy for a particular purpose. The amount of tax due equals the taxable value of property multiplied by the mill levy.[38]

a. Statewide Levies

The eventual tax bill includes a variety of levies. For example, under state law the legislature must impose a mill levy sufficient to raise "the amount necessary to meet the appropriations made for the 2 succeeding fiscal years and for the payment of deficiencies if any have occurred in the previous fiscal year or fiscal years."[39] That levy may not exceed "2 ½ mills on each dollar of valuation."[40] In addition, under a measure enacted by Montana voters, the Montana University System garners the revenues of a six mill levy.[41]

The property tax provides only a minor portion of the revenue generated at the state level.[42] Other governmental entities levy additional property taxes. What follows is not a comprehensive list of all possible mill levies and their limits, but rather a representative sample to provide a picture of overall property tax levies.

b. Elementary and Secondary Education Funding

School funding is perhaps the most complicated area of property tax

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MONT. CODE ANN. §§ 15-6-131 to -150 (1987).

35. MONT. CODE ANN. § 15-6-134 (1987).

36. BIENNIAL REPORT, *supra* note 12, at 48. See also BLACK'S LAW DICTIONARY 896 (5th ed. 1979).

37. *E.g.*, MONT. CODE ANN. § 7-6-2502 (1987).

38. BIENNIAL REPORT, *supra* note 12, at 48. An example of this calculation is set out in the text accompanying notes 72-74, *infra*.

39. MONT. CODE ANN. § 15-10-101 (1987).

40. *Id.*

41. MONT. CODE ANN. § 15-10-105 (1987) (temporary statute). Montana voters have consistently imposed this levy every decade since 1914, although for varying numbers of years. E. WALDRON & P. WILSON, ATLAS OF MONTANA ELECTIONS, 1889-1976 240 (1978). The voters most recently reenacted the 6 mill levy through Legislative Referendum 106 in November, 1988. SECRETARY OF STATE, 1988 OFFICIAL CANVASS.

42. For example, in 1978 the state received only 1.3 % of its total revenue from the property tax. WE THE PEOPLE, *supra* note 21 at 205.

finance and a challenging area for tax reform. Historically, Montana schools have relied largely on local property tax revenue. In 1988, 56.8% of all property taxes levied in Montana went to public schools.[43] Counties raised much of this money locally through statutory,[44] permissive,[45] and voted[46] levies. The state's school foundation program raised additional property tax revenue and distributed it statewide to districts based upon need.[47]

The Montana Supreme Court recently struck down the state's system of school funding as a violation of the right to equal educational opportunity guaranteed by the Montana Constitution.[48] This decision rested on extensive findings of fact as to "disparities of spending per pupil as high as 8 to 1 in comparisons between similarly-sized school districts."[49] The differences result from disparities in the total taxable value of property from one school district to another. This resulted in differing amounts of revenue even when the districts levy the same number of mills.[50] The evidence demonstrated major differences based on the wealth of school districts, unrelated to any educationally pertinent factors.[51] The court concluded that Montana's "excessive reliance on permissive and voted levies" has denied students the right to equal educational opportunity.[52]

During its 1989 regular session, the Legislature failed to reach a consensus on how to respond to the constitutional requirement of equal education funding. Disagreement centered on whether reform of the education finance system should rely on increased statewide property taxes or on a sales tax.[53] At the time of this writing, a special session of the Legislature is prepared to convene to restructure Montana's system of education finance.[54]

c. *Local Government Finance*

Local governments also levy property taxes each year in an amount calculated to meet the spending the government entity plans for the year. Basic county general fund mill levies may run as high as 27 mills annually.[55] Counties also impose various other levies of up to 6 mills for sup-

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43. BIENNIAL REPORT, *supra* note 12, at 134.
44. MONT. CODE ANN. § 20-9-142 (1987).
45. MONT. CODE ANN. § 20-9-352 (1987).
46. MONT. CODE ANN. § 20-9-353 (1987).
47. MONT. CODE ANN. §§ 20-9-301 to -344 (1987).
48. Helena Elementary School Dist. No. 1 v. State, ___ Mont. ___, ___, 769 P.2d 684, 690; *see infra* text accompanying notes 219-29 (discussing the implications of this decision).
49. *Id.* at ___, 769 P.2d at 686.
50. *Id.*
51. *Id.* at ___, 769 P.2d at 690.
52. *Id.*
53. *Legislature Calls it Quits with Tough Issues Hanging*, Missoulian, April 22, 1989, at 1, col. 1.
54. *Governor's Call*, *supra* note 9.
55. MONT. CODE ANN. § 7-6-2501 (1987). The limit is 25 mills on property in classes one, two, and three. *Id.*

port of district courts,[56] as much as 10 mills for county-run nursing homes and hospitals,[57] and various special services.[58] Alternatively, counties may replace most, but not all, of its individual levies with a single all-purpose levy, which may reach a maximum of 55 mills.[59] Counties may exceed any of these limits by a majority vote of the local electors.[60]

Municipalities may also levy taxes on property.[61] The levy for general municipal or administrative purposes may not exceed 24 mills.[62] Like counties, municipalities may impose additional levies for certain special purposes, such as transportation for senior citizens and the handicapped,[63] and construction and operation of airports.[64] As an alternative to imposing the general fund levy and a plethora of special purpose levies, municipalities, like counties, may instead impose an all-purpose levy, limited to 65 mills.[65] Even then, however, municipalities may impose additional levies for bonded indebtedness, judgments, tax protest refunds, or for special improvement district revolving funds.[66] Municipalities may also exceed mill levy limits by majority vote of the local electors.[67]

The Montana Constitution allows additional local policy-making discretion to local governments with self-government charters.[68] The adoption of self-government charters allows localities to exercise all powers not forbidden by the constitution, state statute, or the charter itself.[69] Self-governing localities are not subject to the mill levy limits set by state law.[70] Such local governments are not restricted to revenue sources specifically authorized by state law, but may impose any tax except a local income tax or sales tax.[71]

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56. MONT. CODE ANN. § 7-6-2511 (1987).

57. MONT. CODE ANN. § 7-6-2512 (1987).

58. These include a bridge levy, MONT. CODE ANN. § 7-14-2502 (1987), recreation levy, MONT. CODE ANN. § 7-16-101 (1987), county fair levy, MONT. CODE ANN. § 7-21-3410 (1987), weed levy, MONT. CODE ANN. § 7-22-2142 (1987), insect pest levy, MONT. CODE ANN. § 7-22-2306 (1987), poor fund levy, MONT. CODE ANN. § 53-2-321 (1987), and developmental disabilities facility levy, MONT. CODE ANN. § 53-20-208 (1987).

59. MONT. CODE ANN. § 7-6-2522 (1987). More precisely, the limit is the lesser of 55 mills or the total number of mills levied in the previous year under the general fund levy and special services levies. *Id.*

60. MONT. CODE ANN. § 7-6-2531(2) (1987).

61. MONT CODE ANN. § 7-6-4401 (1987). Municipalities include cities and towns. *Id.*

62. MONT. CODE ANN. § 7-6-4405 (1987). The statute actually expresses this limit as 2.4% of taxable value. This percentage has been converted into mills for the sake of consistency.

63. MONT. CODE ANN. § 7-14-111 (1987).

64. MONT. CODE ANN. § 67-10-402 (1987).

65. MONT. CODE ANN. § 7-6-4452 (1987).

66. MONT. CODE ANN. § 7-6-4453 (1987).

67. MONT. CODE ANN. § 7-6-4431 (1987).

68. MONT. CONST. art. XI, § 6.

69. *Id. See also* MONT. CODE ANN. § 7-1-101 (1987).

70. MONT. CODE ANN. § 7-1-114(1)(g) (1987).

71. MONT. CODE ANN. § 7-1-112(1) (1987). Resort communities may impose sales taxes under limited circumstances. MONT. CODE ANN. §§ 7-6-4461 to -4467 (1987).

d. Calculation of Tax Due

The actual tax liability on a particular piece of property will depend upon whether the property is located inside a municipality, whether the property lies within other taxing jurisdictions, whether the various taxing entities levy their maximum tax, whether local governments elect to impose all-purpose levies, whether the local voters authorize an override of the limits, and on the amount levied for schools. It is therefore not possible to calculate the ultimate tax liability on a given piece of property without knowing the particular levies applicable at its location.

An example may illustrate the calculation of the final property tax. Property located within the City of Missoula in the 1988 tax year was subject to the following levies: 129.76 mills for the City of Missoula, 72.78 mills for Missoula County, 18.00 mills for the state, 92.49 mills for Missoula School District # 1 (elementary), 59.89 mills for the Missoula County High School District, 80.70 mills for county-wide school levies, and 9.82 mills for urban transportation.[72] These levies total 463.44 mills. In our earlier example of a house with an assessed valuation of $100,000, the taxable value was calculated at $3,860.00.[73] Because one mill equals one tenth of one cent for each dollar of taxable value, application of mill levies totaling 463.44 mills results in a tax due of $1,788.88.[74]

C. The Need for Reform

1. Montana's Property Tax Problem

In 1986, Montana voters passed Initiative 105,[75] clearly expressing their desire for property tax reform. That initiative froze property taxes at their 1986 levels, but invited the legislature to consider full scale property tax reform.[76] This demand for reform becomes all the more apparent when viewed in light of the fact that over four voters in ten favored Constitutional Initiative 27, which would have abolished property taxes entirely.[77]

Specific grievances against Montana's property tax system include

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72. Letter from Mr. James Fairbanks, Missoula County Assessor, to the author (Feb. 17, 1989) (confirming a letter from the author to Mr. Fairbanks dated Feb. 15, 1989). This document sets forth the mill levies, based on information provided by Mr. Fairbanks in a telephone interview on January 27, 1989, and Mr. Fairbanks' confirmation of the figures. It is currently on file in the offices of the Montana Law Review. These figures reflect the Assessor's compilation of individual levies by each taxing authority in the jurisdiction. The author wishes to thank Mr. Fairbanks for his courtesy in providing this information.

73. *See supra* text accompanying note 35.

74. Because a mill is one-tenth of a cent per dollar of taxable value, 463.44 mills equals $0.46344 per dollar of taxable value. Multiplying that figure by $3,860, our hypothetical taxable value results in $1,788.88 tax due.

75. 1986 CANVASS, *supra* note 6.

76. Initiative 105, § 1, 1986 VOTER PAMPHLET, *supra* note 6, at 23. *See also infra* text accompanying notes 94-115.

77. 1986 VOTER PAMPHLET, *supra* note 6, at 16 § 2. The voters rejected Constitutional Initiative 27 by a margin of 56% against to 44% in favor. 1986 CANVASS, *supra* note 6.

complaints of the high cost of home ownership, the harm to Montana's competitive position in attracting business, and the considerable burden of administration.[78] Objections to the property tax also stem from the relation, or lack thereof, between property values and the ability to pay taxes. As economists Beatty and Young argued, "[W]ealth as measured by the market value of real or personal property or units of natural resources extracted is fraught with difficulties as a good measure of, or even minimally acceptable proxy for, ability to pay."[79] This problem is particularly acute in Montana.

Montana's property taxes are among the highest in the nation. In 1987, Montana's property taxes were the fourth highest in the nation when calculated as a percentage of per capita income, and the tenth highest per capita.[80] The property tax accounts for 19.9% of Montana's state and local revenue, on a per capita basis from all sources, compared to a national average of 14.3% .[81] A 1978 legislative study indicated that only five states collect more property taxes per $1,000 of personal income than Montana.[82] A different authority concluded that in 1979 Montana ranked fourth in property tax as a share of personal income, and eighth in property tax per capita.[83] Another analysis concluded that in 1986 Montana ranked ninth in the nation in property taxes paid per capita.[84] The precise ranking may vary depending upon the criteria used for measurement, and on the year in which the data was collected. The conclusion remains inescapable, however, that Montana's property tax burden is out of line with that imposed by other states.

This heavy reliance on the property tax becomes most apparent at the local level. Following a consistent pattern dating back to statehood,[85] Montana law restricts local governments primarily to the property tax as a revenue source.[86] An analysis of property tax expenditures illustrates this reliance. In the 1986-88 biennium, 56.8% of property tax revenue went to elementary and secondary education.[87] Counties received the second highest share, with 20.7% of property tax collections.[88] Cities and

78. BEATTIE & YOUNG, *supra* note 3, at 3-4.

79. *Id.* at 7.

80. CAL-TAX NEWS, *supra*, note 5, at 4 (citing statistics compiled by the U.S. Dept. of Commerce, Bureau of the Census).

81. *See* BEATIE & YOUNG, *supra* note 3, at 14.

82. COMPARING TAX BURDENS, *supra* note 5, at 4.

83. WE THE PEOPLE, *supra* note 21, at 234.

84. BEATTIE & YOUNG, *supra* note 3, at 37.

85. WE THE PEOPLE, *supra* note 21 at 234-35.

86. Parts 25 and 44 of Title 7 of the Montana Code Annotated authorize property tax collections by counties and municipalities respectively. Provisions authorizing other taxes are virtually non-existent, except as to local governments with self-government charters. Those localities may levy any tax except for a local income tax or sales tax. MONT. CODE ANN. § 7-1-112(1) (1987).

87. BIENNIAL REPORT, *supra* note 12, at 134.

88. *Id.*

towns received 13.8% of revenue, and fire districts gathered 6.5%.[89] The state, including levies for the university system and for livestock, received only 2.2%.[90]

As local governmental spending has increased, and federal revenue sharing has decreased, local authorities unable to raise revenue from alternative sources placed a greater burden on the property taxpayer.[91] In 1975 property taxes accounted for approximately ninety-five percent of local government's tax revenue.[92] Not only does this state of affairs place a tremendous burden on the property taxpayer, it also denies local governments the flexibility to tailor their revenue collection to the conditions of their particular localities.[93]

2. *Initiative 105: The Voters' Call for Reform*

When Montana voters passed Initiative 105, they declared as a matter of policy that "Montana's reliance on the taxation of property to support education and local government has placed an unreasonable burden" on property owners.[94] Initiative 105 also decried the lack of local flexibility in developing sources of revenue, and expressed the fear that ignoring calls for reform "will only lead to increases in the tax burden on the already overburdened property taxpayer."[95] The voters expressly called upon the legislature to reform the property tax system by developing "(a) a tax system that is fair to property taxpayers; and (b) a method of providing adequate funding for local government and education."[96] Initiative 105 represented the efforts of Montanans of moderate political temperament to gain control over what they regarded as excessive property taxation. Contrasted with its more severe companion on the November, 1986 ballot, Constitutional Initiative 27, Initiative 105 sought to reform property taxes, not abolish them.[97]

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89. *Id.* The figure for cities and towns includes 5.4% for special improvement districts. *Id.*

90. *Id.*

91. *Local Fiscal Impact of the Loss of General Revenue Sharing: Hearings Before the Subcommittee on Governmental Efficiency, Federalism, and the District of Columbia of the Senate Committee on Governmental Affairs*, 100th Cong., 1st Sess. at 50 (1987) (testimony of Comptroller General of the United States Charles A. Bowsher). *See also* WE THE PEOPLE, *supra* note 21, at 234.

92. WE THE PEOPLE, *supra* note 21, at 234.

93. *Id.* at 236. The Montana Constitution embodies a policy of allowing communities to tailor their local governments to local desires and conditions. *Id.* at 215; MONT. CONST. art. XI. Though proper in any state, this policy seems particularly appropriate in a state such as Montana with its significant social, economic, and geographic differences. The Montana Constitution provides localities with the option of choosing among alternate forms of government, MONT. CONST. art. XI, § 3, and allows for self-government charters to increase local autonomy, MONT. CONST. art. XI, § 5.

94. MONT. CODE ANN. § 15-10-401(1) (1987). This statute codifies section one of Initiative 105. *See* Initiative 105, § 1, 1986 VOTER PAMPHLET, *supra* note 6, at 23.

95. MONT. CODE ANN. § 15-10-401(2) (1987).

96. MONT. CODE ANN. § 15-10-401(3) (1987).

97. *Ballot Argument For Initiative 105*, 1986 VOTER PAMPHLET, *supra* note 6, at 14.

The drafters of Initiative 105 chose the legislature over the initiative process as the appropriate forum for considering "difficult and complex decisions" of tax reform,[98] and included a major incentive for the legislature to enact reforms. The initiative freezes property taxes at 1986 levels for agricultural land, most residential and commercial property, livestock and agricultural products, various commercial personalty, mobile homes, and improvements on agricultural land.[99] New construction and improvements are taxed at 1986 levels.[100] The initiative further provides that this halt in property tax increases "does not apply to levies for rural improvement districts . . . , special improvement districts . . . , or bonded indebtedness."[101] This limitation to 1986 levels means a freeze of "the actual dollar amount of taxes imposed on an individual piece of property . . ."[102] Therefore if assessed values rise due to an increase in market value, or if tax rates or mill levies change, the actual number of tax dollars due against a particular piece of property cannot increase.

This rigid limitation indicates that its drafters never intended Initiative 105 to become a permanent tax reform measure. Even the most ardent advocates of property tax limitation acknowledge that increases in the cost of living apply to governments as well as to citizens.[103] It appears that the drafters of the initiative intended that the erosion of revenues through inflation should induce the legislature to take action of its own. The proponents of the measure argued that it would "force[] the Legislature to face the reality of an unbalanced tax system that fails to produce adequate revenues to fund government."[104]

Initiative 105 articulated its call for thorough property tax reform in an uncodified provision. Section 3 of the initiative declares that the prop-

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Constitutional Initiative 27 would have amended the state constitution to forbid property taxes entirely. *Id.* at 16. The voters enacted Initiative 105 while rejecting Constitutional Initiative 27. 1986 CANVASS, *supra* note 6.

98. MONT. CODE ANN. § 15-10-401(3) (1987). Authorities have often criticized the Montana legislature for its shameful history of corruption and servile obedience to powerful economic interests. *See, e.g.*, K. TOOLE, TWENTIETH CENTURY MONTANA: A STATE OF EXTREMES 259-60 (1972). Some have argued that this history makes the legislature unsuitable for resolving important problems. State *ex rel.* Montana Citizens for the Preservation of Citizens' Rights v. Waltermire, ___ Mont. ___, ___, 729 P.2d 1283, 1296 (1986) (Sheehy, J., dissenting). *See also* Harper v. Greely, ___ Mont. ___, ___, 763 P.2d 650, 657 (1988) (Sheehy, J., dissenting). However, Professor Lopach argues compellingly that this background should not color the perception of the legislature under the 1972 constitution. Lopach, *The Montana Supreme Court in Politics*, 48 MONT. L. REV. 267, 268-70 (1987). The balance of governmental powers necessary for a well-functioning political system necessitates a proper respect for the legislature in its reformed condition. *Id.* at 270.

99. MONT. CODE ANN. § 15-10-402(1) (1987). This statute codifies § 2 of Initiative 105. *See* Initiative 105, § 2, 1986 VOTER PAMPHLET, *supra* note 6, at 23.

100. MONT. CODE ANN. § 15-10-402(3) (1987).

101. MONT. CODE ANN. § 15-10-402(2) (1987).

102. MONT. CODE ANN. § 15-10-402(4) (1987).

103. California's Proposition 13, the archetype of tax-limitation measures, allows increases in the assessed value of property when transferred or newly constructed, CAL. CONST. art. XIIIA, § 2(a), or in a limited way for inflation, CAL. CONST. art. XIIIA, § 2(b).

104. *Ballot Argument for Initiative 105*, 1986 VOTER PAMPHLET, *supra* note 6, at 14.

erty tax freeze would not go into effect if, prior to July 1, 1987, the legislature were to enact legislation that:

> (a) states that it is being enacted in response to this initiative;
> (b) reduces property tax on a statewide basis on property [in certain classes]; and
> (c) establishes alternative revenue sources to replace revenue lost to local governments, school districts, the university system, and other property taxing jurisdictions as a result of the reduced property taxes.[105]

The legislature enacted no such legislation during its 1987 session. Instead it simply enacted two provisions to implement, and slightly amend,[106] the property tax freeze. While Initiative 105 halted tax increase only on certain classes of property, the legislature extended that freeze to all classes.[107] The implementing act also specified that the actual dollar amount of taxes due may increase where property is subdivided, annexed into a new taxing unit, transferred to a new taxing unit, reclassified, or newly constructed.[108]

The legislature also provided that a taxpayer's tax liability may exceed 1986 levels if the total taxable valuation of all property within a taxing jurisdiction decreases by five percent or more from the previous tax year.[109] If the aggregate taxable value decreases by five percent or

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105. Initiative 105, § 3, 1986 VOTER PAMPHLET, *supra* note 6, at 23.

106. In 1920, the Montana Supreme Court held that the legislature has the authority to amend voter enacted initiatives, reasoning that the constitutional amendment creating the initiative power did not restrict the people's delegation of legislative powers to their elected representatives. State *ex rel.* Goodman v. Stewart, 57 Mont. 144, 150-51, 187 P. 641, 643 (1920). The Attorney General has concluded that the 1972 Constitution did not alter this rule. 42 Op. Mont. Att'y Gen. 21 at 5 (1987).

107. MONT. CODE ANN. § 15-10-412(1) (1987). As originally enacted, this statute was to terminate on December 31, 1989. MONT. CODE ANN. § 15-10-412 (1987). The 1989 Legislature enacted a measure to make this statute permanent. S.B. 65, 51st Mont. Leg., Reg. Sess., § 1 (1989). As of this writing, the bill awaited the signature of Governor Stephens.

108. MONT. CODE ANN. § 15-10-412(3) (1987). Attorney General Greely determined that Initiative 105 does not limit the taxes levied by a new taxing entity created after 1986. 42 Op. Mont. Att'y Gen. 80 (1988). This opinion could be challenged where evasion of the tax freeze motivated formation of the taxing unit. *See* Los Angeles County Transp. Comm'n v. Richmond, 31 Cal. 3d 197, 213, 643 P.2d 941, 950, 182 Cal. Rptr. 324, 333 (1982) (Richardson, J., dissenting). A similar challenge to a tax under California's Proposition 13 recently succeeded at the trial court level. Rider v. County of San Diego, No. 194690 (Riverside County Superior Court) (March 21, 1989). An appeal to California's Fourth District Court of Appeal is anticipated following the resolution of an unrelated motion before the trial court.

109. MONT. CODE ANN. § 15-10-412(7) (1987). A bill passed by the 1989 Legislature substituted "1986" for "previous" in subsection 7. S.B. 65, 51st Mont. Leg., Reg. Sess., § 1. This amendment allows mill levies to increase where property values have fallen five percent or more relative to the 1986 tax year, rather than relative to the immediately preceding year. *Id.* It also has the effect of negating the opinion of the Attorney General that taxing entities could avail themselves of MONT. CODE ANN. § 15-10-412 (7) for more than one year at a time only where property values continued to fall by five percent or more each year. *See* 42 Op. Mont. Att'y Gen. 21 (1987). This result follows because taxing entities may impose increased property taxes where values are five percent below the 1986 level, rather than only if five percent below the previous year's level. S.B. 65, § 1. At the time of this writing, this

more, the taxing entity may raise the mill levy by an amount calculated to raise the same number of dollars as the 1986 levy.[110] This might result in an increased dollar amount of tax on a particular piece of property if that property has not itself decreased in value by five percent, because taxing entities must impose an equal number of mills against all property within the jurisdiction.[111] In addition, the legislature allowed for increases in the amount of taxes upon voter approval.[112]

Initiative 105 amounted to a call for reform, rather than an enactment of reform. The state government should address property tax reform in a carefully planned response to Initiative 105. The 1987 Legislature, however, simply propped up a series of temporary measures and evaded the real question of tax reform.[113] The legislature deadlocked during its 1989 regular session, adjourning without enacting any significant property tax reform.[114] This article goes to press as the governor and legislators plan a special session for June of 1989 to consider school funding issues and potentially sweeping reforms of the state's revenue structure.[115] Hopefully, the legislative resolve to comprehensively address this difficult issue will still emerge.

Tax reform means more than a simple freeze. It means a careful balancing of alternative sources of revenue. It means setting priorities between public sector and private sector needs amid tough economic circumstances. The time has come for the legislature to address this problem in a thorough way.

III. CALIFORNIA'S EXPERIENCE WITH PROPERTY TAX REFORM

California's experience with property tax reform provides useful guidance to other states seeking to provide relief to overburdened prop-

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bill awaited the signature of Governor Stephens.

110. MONT. CODE ANN. § 15-10-412(7) (1987).

111. The statute simply limits the levy to the "number [of mills] calculated to equal the revenue from property taxes for the 1986 tax year in that taxing unit." MONT. CODE ANN. § 15-10-412(7) (1987). The Attorney General has concluded that levies must impose a uniform number of mills on all property within a jurisdiction. 42 Op. Mont. Att'y Gen. 129 (1988).

112. MONT. CODE ANN. § 15-10-412(9) (1987).

113. *See* BEATTIE & YOUNG, *supra* note 3 at 38. Beattie and Young note a similar failure to come to terms with the economic situation confronting the state. "The [Montana] Legislature has responded with a series of temporary solutions, including salary freezes, across-the-board expenditure cuts, a surtax on the income tax, and spending from trust funds. These actions clearly do not represent a long-run solution." *Id.*

114. *Special Session Looms*, Missoulian, April 18, 1989, at 1, col. 3. Bills introduced but not adopted included proposals to reduce or limit property taxes, S.B. 158, 51st Mont. Leg., Reg. Sess. (1989), S.B. 451, 51st Mont. Leg., Reg. Sess. (1989), H.B. 475, 51st Mont. Leg., Reg. Sess. (1989), or to amend Initiative 105 in various ways to permit property tax increases. S.B. 2, 51st Mont. Leg., Reg. Sess. (1989); H.B. 125, 51st Mont. Leg., Reg. Sess. (1989). Several bills proposed the adoption of a sales tax. H.B. 747, 51st Mont. Leg., Reg. Sess. (1989); S.B. 456, 51st Mont. Leg., Reg. Sess. (1989); S.B. 469, 51st. Mont. Leg., Reg. Sess. (1989).

115. *Governor's Call*, *supra* note 9.

erty taxpayers. It supplies an example of one way in which the people of a state have sought reform and of lessons learned as government has reacted to reform. What evolved in California demonstrates that policy makers should consider not only tax cuts, but the overall design of an equitable revenue system. Without such planning, revenue devices may emerge based more on opportunity than policy.

This section begins with a discussion of Proposition 13, an initiative amendment to the California Constitution. It then considers the legislative response to that initiative and the loss of local control over local government decision-making that resulted. Finally, the section reviews the court decisions that have ultimately shaped the implementation of Proposition 13.

A. Proposition 13

California's Proposition 13 stands out as the archetype of tax limitation measures nationwide.[116] Its successes and failures therefore provide vital lessons for any state considering property tax reform. An examination of the California experience can shed light on Montana's property tax reform efforts.

The context of the passage of Proposition 13 illuminates the motives behind its adoption and the terms of its specific provisions. Prior to Proposition 13, California imposed among the highest levels of taxation of any state.[117] Motivations for the tax reduction movement in California included not only the desire to control high tax rates, but also the desire to protect home owners from the tax effects of skyrocketing real estate values. As inflation and population growth forced real estate values higher, property tax assessments,[118] and the resulting tax levies, increased

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116. UNIVERSITY OF CALIFORNIA, DAVIS, EXTENSION, PROPOSITION 13, TEN YEARS LATER: FINANCES, LOCAL CONTROL, AND THE COMMON GOOD at 1 (1988) [hereinafter PROPOSITION 13, TEN YEARS LATER] (remarks of Theodore L. Hullar, Chancellor, University of California, Davis). This publication summarizes the proceedings of a Public Issues Forum presented by the University Extension of the University of California, Davis, June 24, 1988, held at Sacramento, California.

117. CALIFORNIA TAX FOUNDATION, UP TO THE LIMIT: ARTICLE XIIIB SEVEN YEARS LATER at 3 (1987) [hereinafter UP TO THE LIMIT]. Specifically, California state and local revenues ranked second highest in the nation when measured on a per capita basis and third highest based on revenue per $1,000 of personal income. *Id.* Another survey ranked California fourth highest in the nation in overall tax burden. COMPARING TAX BURDENS, *supra* note 5, at 4-5.

In the year before the adoption of Proposition 13, California's overall tax burden, from all tax sources, was 27% above the national average. Comment, *Police and Fire Service Special Assessments Under Proposition 13*, 16 U.S.F. L. REV. 781, 783 n.17 (1982) [hereinafter *Special Assessments*] (citing SECURITY PACIFIC NATIONAL BANK, TAXES AND OTHER REVENUE OF STATE AND LOCAL GOVERNMENT IN CALIFORNIA, A4-A6 (1982)).

118. According to one local assessor, "In the late sixties, the reappraisals that were being done by local assessors' offices were causing increases of between 30 to 100 percent in individual property values." PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 8 (remarks of Fresno County Assessor William G. Greenwood). Statistics presented to the United States Senate by Senator Henry Bellmon indicate that those increases accelerated just prior

dramatically.[119]

In 1978, California voters enacted Proposition 13 by a wide margin that swept across political and demographic lines.[120] The initiative added article XIIIA to the California Constitution. The first section of the new article limits ad valorem[121] taxes on real property to "[o]ne percent (1%) of the full cash value of property."[122]

Proposition 13 specially defined the term "full cash value" to prevent taxes from increasing due to spiraling real estate values, despite the limit on the tax rate. The initiative defined full cash value as the assessed value of the property in the 1975-76 tax year, "or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment."[123] In addition, assessors may adjust full cash value each year for inflation, not to exceed two percent.[124]

This reassessment mechanism changes the property tax system from one of a tax based on current market value to one based on acquisition value[125] with a limited adjustment for inflation. The drafters of Proposition 13 included this provision to make tax relief meaningful by insulating property owners from taxes on the unrealized paper gains in the value of their property.[126] Some commentators have severely criticized its effect.[127] Taxing property on its value at the date of acquisition sometimes

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to the enactment of Proposition 13. "In the last two years, the lid has blown off. Largely due to skyrocketing property values, Californians have been experiencing average real estate tax hikes of 100 percent to 150 percent." 124 CONG. REC. 19708 (1978).

119. V. RAYMOND, SURVIVING PROPOSITION THIRTEEN: FISCAL CRISIS IN CALIFORNIA COUNTIES at 1 (1988). *See also* PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 1 (remarks of Theodore L. Hullar).

120. Overall, Proposition 13 received a 64.8% "yes" vote. Moreover, 55 % of Democrats supported it, and 51 % of voters with college and graduate degrees voted yes. UP TO THE LIMIT, *supra* note 117, at 1.

121. "[A]n ad valorem tax . . . is any source of revenue derived from applying a property tax rate to the assessed value of property." Heckendorn v. City of San Marino, 42 Cal. 3d 481, 483, 723 P.2d 64, 64-65, 229 Cal. Rptr. 324, 324 (1986). In other words, it is a tax based on the value of the property.

122. CAL. CONST. art. XIIIA, § 1(a). This limit does not apply to taxes levied to pay for voter-approved indebtedness. CAL. CONST. art. XIIIA, § 1(b). For judicial interpretation of the debt provision, see generally, Patton v. City of Alameda, 40 Cal. 3d 41, 706 P.2d 1135, 219 Cal. Rptr. 1 (1985); Carman v. Alvord, 31 Cal. 3d 318, 644 P.2d 192, 182 Cal. Rptr. 506 (1982); Arvin Union School Dist. v. Ross, 176 Cal. App. 3d 189, 221 Cal. Rptr. 720 (1985); City of Watsonville v. Merrill, 137 Cal. App. 3d 185, 186 Cal. Rptr. 857 (1982); Metropolitan Water Dist. of S. Cal. v. Dorff, 98 Cal. App. 3d 109, 159 Cal. Rptr. 211 (1979); Kern County Water Agency v. Board of Supervisors, 96 Cal. App. 3d 874, 158 Cal. Rptr. 430 (1979).

123. CAL. CONST. art. XIIIA, § 2(a). For a thorough discussion of valuation procedures under Proposition 13, see 1 R. CRAWFORD III & W. THOMAS, CALIFORNIA TAXES §§ 1.56, 1.57 (2d ed. 1988).

124. CAL. CONST. art. XIIIA, § 2(b).

125. Shafer v. State Bd. of Equalization, 174 Cal. App. 3d 423, 427, 220 Cal. Rptr. 59, 61 (1985).

126. Amador Valley Joint Union High School Dist. v. State Bd. of Equalization, 22 Cal. 3d 208, 235, 583 P.2d 1281, 1293, 149 Cal. Rptr. 239, 251 (1978).

127. *Challenge to Prop. 13*, L.A. Times, Jan. 22, 1989, at D.V.4, col. 1 (editorial urging

creates large disparities in the taxes due against property of similar current market values.[128] The California Supreme Court has upheld this reassessment mechanism from an equal protection challenge.[129] Other methods might have limited increases caused by rising property values, such as reducing rates when assessed values rise. Further reform may occur in this area.[130]

Proposition 13 also contains a provision intended to prevent the circumvention of the limitation on property taxes by imposing new burdens on property owners.[131] The drafters of Proposition 13 included this provision "to prevent the government from recouping its losses from decreased property taxes by imposing or increasing other taxes" except by popular vote.[132]

Proposition 13 was only one in a continuing series of initiatives attempting to bring about tax reform in California.[133] Examples of initia-

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a lawsuit challenging Proposition 13 on equal protection grounds); *Property Tax Warning*, Sacramento Bee, Jan. 23, 1989, at B10, col. 1 (editorial urging correction of this aspect of Proposition 13).

128. According to one report, "Since home prices have soared in most areas of California, new owners can pay as much as 10 times more in property taxes than neighbors who have owned their homes since the mid-1970s." *High Court Tax Edict May Bring Test of Prop. 13*, L.A. Times, Jan. 19, 1989, at 1, col. 3.

129. *Amador*, 22 Cal. 3d at 235, 583 P.2d at 1291, 149 Cal. Rptr. at 251. A recent decision by the United States Supreme Court struck down on equal protection grounds a superficially similar practice by one county assessor in West Virginia. Allegheny Pittsburgh Coal Co. v. County Comm'n, 109 S. Ct. 633, 634 (1989). However, the assessor in West Virginia had violated West Virginia's own law, which required equal taxation based on current market value. *Id.* at 638. The standard adopted by the Court indicates that California's policy of effectively limiting tax increases by refusing to tax the unrealized paper increase in value would suffice from an equal protection standpoint. The Court noted that, " '[i]f the selection or classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law.' " *Id.* (quoting Brown-Forman Co. v. Kentucky, 217 U.S. 563, 573 (1910)). *See also* Garret Freightlines, Inc. v. Montana R.R. and Pub. Serv. Comm'n., 161 Mont. 482, 499, 507 P.2d 1040, 1047 (1973). Nothing can be certain in this regard and in any event the question of constitutionality is not the same as the question of policy. The real issue is whether this was the best policy the drafters of Proposition 13 might have devised.

130. Aside from the basic fairness question, "[o]ne of the inherent problems with all forms of taxation is that the effective prices or cost of taxed resources and goods and services become distorted and no longer reflect true 'scarcity or market value.' " BEATTIE & YOUNG, *supra* note 3, at 7. The difference between the value of property in the hands of a current owner and the same property's value in the hands of a potential buyer could distort economic decisions.

131. CAL. CONST. art. XIIIA, § 4.

132. Huntington Park Redevelopment Agency v. Martin, 38 Cal. 3d 100, 105, 695 P.2d 220, 222, 211 Cal. Rptr. 133, 135 (1985). The provision has met with only partial success in this regard. *See infra* text accompanying notes 160-213.

133. From 1968 to 1986, California voters considered thirteen separate initiatives for tax reform, adopting eight of them. UP TO THE LIMIT, *supra* note 117, at 1. Proposition 1 of 1973 foreshadowed the general theme of Proposition 13. Sponsored by then-Governor Ronald Reagan in 1973, that measure was actually drafted by now-United States Supreme Court Justice Anthony M. Kennedy. *Judge Kennedy's Comments on Issues*, S.F. Chronicle, Dec. 15, 1987, at A13, col. 2.

tives enacted to follow up on Proposition 13 include Proposition 4, which established spending limits for state and local governments,[134] and Proposition 62, intended to require voter approval for all new or increased local taxes.[135]

B. The Legislative Response to Proposition 13: Loss of Local Control

The attempts by the California legislature to reallocate state and local revenues following the enactment of Proposition 13 have had severe, and usually negative, policy implications for the relationship between state and local governments. Other states, including Montana, that rely excessively on the property tax as a source of local revenue, should carefully consider the results of California's legislative response before attempting to restructure their systems of local government finance. California's response resulted in a major curtailment of local control over policies and expenditures. A concern for the ability of local governments to provide local solutions to local problems counsels caution. Tax reform should not result in centralization of authority in the state government.

1. Proposition 13 Implementing Legislation

The legislature's prime focus in responding to Proposition 13 has been to channel state revenue into local government. The legislature's response has consisted primarily of three bills, Senate Bill 154,[136] a package of state aid to local governments passed immediately after Proposition 13, Assembly Bill 8,[137] passed in 1979, and "The Long Term Financing Act of 1984".[138]

The legislature rushed its first bill, Senate Bill 154, into effect to beat the July 1, 1978 effective date of Proposition 13.[139] As a result, Senate Bill 154 bears few signs of any careful consideration of the fundamental issues involved when the state begins channeling revenue to local governments.[140] For example, the bill contained a system for distributing property tax revenues among the various governmental entities within a county in the same proportions as prevailed prior to Proposition 13.[141] This system has caused residents of cities that previously imposed little or no property tax to subsidize other cities that charged higher tax rates prior to Proposition 13.[142] The legislature also provided local governments

134. CAL. CONST. art. XIIIB.

135. CAL. GOV'T CODE §§ 53720-53730 (West. Supp. 1989). The California Court of Appeal has recently invalidated retroactive enforcement of Proposition 62. City of Westminster v. County of Orange, 204 Cal. App. 3d 623, 631, 251 Cal. Rptr. 511, 515-17 (1988).

136. 1978 Cal. Stat. 292.

137. 1979 Cal. Stat. 282.

138. 1984 Cal. Stat. 448. *See also* RAYMOND, *supra* note 119, at 8.

139. RAYMOND, *supra* note 119, at 8.

140. *Id.*

141. 1978 Cal. Stat. 292, §§ 24-32. This system, as amended, is codified in CAL. REV. & TAX. CODE §§ 97-100 (West Supp. 1989).

142. R. SMITH, J. JOHNSON, & W. STUBBLEBINE, CONSTITUTIONAL REFORM GONE AWRY:

with funding for various programs that had previously depended upon local government revenue.[143] This aid, however, came with strings attached in the form of state requirements for certain local spending, including specified levels of police and fire protection, health services, and a limitation on pay raises for local employees.[144]

Although the legislature has since enacted two long term Proposition 13 implementation bills, it has never thoroughly rethought the relationship between state and local government.[145] Both Assembly Bill 8 and "The Long Term Financing Act of 1984" continued the policy of providing state aid to local governments and requiring local governments to spend much of the money in ways dictated by the state.[146]

2. *Loss of Local Government Autonomy*

As a result of the legislature's implementing legislation, local governments in California today enjoy substantially less autonomy from the state government than they had previously. This change did not occur as a direct result of Proposition 13, but rather resulted from the actions chosen by the legislature after the enactment of Proposition 13. Proposition 13 cut taxes; the legislature allocated those cuts.

By parceling out money to local governments with strings attached, the state has increased its power over a variety of local functions.[147] The drafters of Proposition 13 did not intend this result.[148] Power and money naturally go together in politics. In California today, "power follows the dollar and the dollars come from Sacramento."[149]

The decline in local autonomy stems from the relatively low proportion of the budget that a local government actually retains the discretion to control. Local governments cannot decide locally what programs to fund and what policies to pursue if the state mandates how to spend the money. For example, in a recent budget year, the Board of Supervisors of San Diego County had discretion in the spending of only $34 million out of a total budget of $1.2 billion.[150] Similarly, the Board of Supervisors of Yolo County retained discretion over eighteen percent of its budget, down

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THE NO-PROPERTY TAX CITIES AND PROPOSITION 13 at 3 (1985).

143. 1978 Cal. Stat. 292, § 15 (enacting Division 4, Part 1.5 of the California Government Code). Further statutes controlling state payments to local governments implementing Proposition 13 are codified in Division 1, Part 0.5, of the California Revenue and Taxation Code, commencing with section 50.

144. 1978 Cal. Stat. 292 § 15.

145. RAYMOND, *supra* note 119, at 8.

146. *Id.* at 10-13.

147. PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 24 (remarks of California State Senator Marion Bergeson).

148. *Id.* (quoting Proposition 13 co-author Paul Gann).

149. *Id.* at 24-25. *See also, Id.* at 41 (remarks of Ruth Gadebusch, Director of the California School Boards Association and Board President of the Fresno Unified School District).

150. *Id.* at 38 (remarks of San Diego County Supervisor George Bailey).

from fifty percent ten years ago.[151] The situation in city governments is somewhat brighter, but the problem remains.[152]

The phenomenon of unfunded state mandates for local services further reduces the proportion of local revenues subject to local discretion. The California Constitution states that when the legislature requires local governments to carry out a new program or a higher level of service (a state mandate), the legislature must provide funding for that program or service.[153] In practice, the legislature often avoids providing this funding. Between 1975 and 1984, nearly 2,400 bills contained mandates, but only 106 actually contained appropriations.[154] Since the adoption of the constitutional provision requiring the state to pay for state mandated local programs, "most of the flagrant abuses have been eliminated."[155] Yet, at least one county is suing the state over inadequate appropriations for mandated programs.[156] The legislature has, however, provided an administrative remedy. Local governments may seek an order from the Commission on State Mandates to the state Controller to provide state funding for a state mandated program.[157]

The solution to the decline of local control caused by the legislative implementation of Proposition 13 must center around a rethinking of the allocation of state and local revenue sources.[158] The problem in doing so is that policy makers encounter two differing views toward the problem. Some view the allocation of local revenue as a quest for the money to finance a list of programs for which they perceive a public demand. Others regard Proposition 13 as an attempt to make choices between pri-

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151. *Id.* at 39 (remarks of Yolo County Supervisor Betsy Marchand).

152. RAYMOND, *supra* note 119, at 1. The effect of Proposition 13 on public schools is less easily discerned. PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 5 (remarks of public finance consultant Kevin Bacon). Just before the adoption of Proposition 13 the California Supreme Court invalidated on equal protection grounds the state's system of financing education through local property taxes. Serrano v. Priest, 5 Cal. 3d 584, 617-18, 487 P.2d 1241, 1264-65, 96 Cal. Rptr. 601, 624-25 (1971); Serrano V. Priest, 18 Cal. 3d 728, 774-75, 557 P.2d 929, 952, 135 Cal. Rptr. 345, 373 (1976), *cert. denied*, Clowes v. Serrano, 432 U.S. 907 (1977). California's current system of education finance therefore developed from a mix of causes, both legal and political, including the supreme court decision, Proposition 13, and the legislative responses to both.

153. CAL. CONST. art. XIIIB, § 6. This is one provision of Proposition 4, the government spending limit adopted by the voters in 1979.

154. RAYMOND, *supra* note 119, at 27. The requirement of funding for state mandates did not become a part of the constitution until the enactment of Proposition 4 in 1979. CAL. CONST. art. XIIIB, § 6. However, a statutory funding guarantee existed prior to that time. RAYMOND, *supra* note 119, at 27.

155. RAYMOND, *supra* note 119, at 27.

156. Bd. of Supervisors, County of Butte v. McMahon, No. 3 Civ. C003383 (Cal. Ct. App., 3rd App. Dist.).

157. CAL. GOV'T CODE § 17615.1 (West Supp. 1989). On the subject of state mandated local costs in general, see CAL. GOV'T CODE §§ 17500-17630 (West Supp. 1989); CAL. REV. & TAX CODE §§ 2201-2327 (West 1989).

158. PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 48 (remarks of Craig Stubblebine, Professor of Economics, Claremont McKenna College, Claremont, California).

vate and public spending, and are therefore reluctant to raise taxes.[159]

C. *Judicial Interpretation of Proposition 13*

Proposition 13 has generated an enormous amount of litigation. California's appellate courts have rendered at least sixty-five published decisions construing various aspects of Proposition 13.[160] This section will analyze the more significant decisions dealing with non-ad valorem taxes and fees.

While the primary effect of Proposition 13 was to place a one percent limit on ad valorem property taxes, the initiative also sought to control the ways in which additional government revenue would be raised. Section four of Proposition 13 provides:

> Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district.[161]

California's experience offers an example of the failure to plan for the consequences of a tax reduction. Governments faced with a significant loss of revenue from one source will naturally look for other sources.[162] The ambiguity of section four has caused the courts, and not the voters or legislature, to determine major policy questions.

The major issue under section four of Proposition 13 concerns the definition of the term "special tax." When a taxing entity seeks to adopt a new revenue-raising device, the tension under Proposition 13 lies in the issue of whether that device constitutes a special tax. This relates to the basic policy question of the form and extent of new revenue sources that should be allowed as a part of an effort to reform the burdens of the property tax system.

The California Supreme Court explained the way in which section four relates to the general tax limitation purpose of Proposition 13. "[S]ince any tax savings resulting from the operation of sections 1[163] and 2[164] could be withdrawn or depleted by additional or increased state or

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159. *Id.* at 47-48.

160. *See* Annotations to CAL. CONST. art. XIIIA (West Supp. 1989).

161. CAL. CONST. art. XIIIA, § 4.

162. Since Proposition 13 limited local governments' use of the property tax, at least 117 cities have raised more than 156 taxes. CALIFORNIA TAXPAYERS' ASSOCIATION, *Proposition 62, Local Tax Increases: Should Voters Have a Say?*, CAL-TAX NEWS, August 15, 1986, at 3. The predominant forms of new taxes have been utility-user taxes, business-license taxes, and transient-occupancy taxes. *Id.*

163. Section 1 provides for a one-percent limit on the tax rate. CAL. CONST. art. XIIIA, § 1.

164. Section 2 sets forth the reassessment limitations. Assessments may increase when property is transferred or newly constructed and by up to two percent annually for inflation. CAL. CONST. art. XIIIA § 2.

local levies of other than property taxes, sections 3[165] and 4 combine to place restrictions upon the imposition of such taxes."[166]

Given this purpose of section four, the litigants in *City and County of San Francisco v. Farrell*[167] called upon the court to determine what taxes would constitute special taxes. *Farrell* involved an increase by the City and County of San Francisco in its payroll or gross receipts tax on businesses.[168] The board of supervisors placed the tax increase on the ballot, and received the support of fifty-five percent of the voters.[169] Farrell, the city's controller, refused to certify that the additional revenues raised through the tax increase were available for spending, arguing that the increase was invalid for lack of approval by a two-thirds vote of the electorate as required by section four.[170] The city responded by filing an original action in the California Supreme Court to resolve the dispute.[171]

Farrell argued that the term "special taxes" referred to any "extra, additional, or supplemental charge imposed . . . to raise money for public purposes."[172] He contended that the purpose of section four, to prevent circumvention of the property tax limit, necessitated this interpretation.[173]

The court disagreed, noting the ambiguity of the drafting of section four.[174] California law had used the term "special taxes" to mean different things in different contexts.[175] The court determined that in the context of Proposition 13, special taxes should mean "taxes which are levied for a specific purpose rather than . . . a levy placed in the general fund to be utilized for general governmental purposes."[176] The court based this conclusion partly on a desire to reduce the scope of the two-thirds vote requirement, which the court disfavored on policy grounds.[177]

Justice Kaus contended in his dissent, "If section 4 was indeed intended to restrict the ability of local entities to replace the property tax losses mandated by Proposition 13, then the interpretation of 'special taxes' adopted by the court is clearly off the mark."[178] Justice Richard-

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165. Section 3 requires a two-thirds vote of members of the legislature for any increase in state taxes. CAL. CONST. art. XIIIA, § 3.

166. Amador Valley Joint Union High School Dist. v. State Bd. of Equalization, 22 Cal. 3d 208, 231, 583 P.2d 1281, 1291, 149 Cal. Rptr. 239, 249 (1978) (footnotes added).

167. 32 Cal. 3d 47, 648 P.2d 935, 184 Cal. Rptr. 713 (1982).

168. *Id.* at 51, 648 P.2d at 936, 184 Cal. Rptr. at 714.

169. *Id.* at 51, 648 P.2d at 937, 184 Cal. Rptr. at 715.

170. *Id.*

171. *Id.*

172. *Id.* at 54, 648 P.2d at 938, 184 Cal. Rptr. at 716.

173. *Id.* at 56, 648 P.2d at 940, 184 Cal. Rptr. at 718 (citing *Amador*, 22 Cal. 3d at 231, 583 P.2d at 1291, 149 Cal. Rptr. at 248-49).

174. *Id.* at 53, 648 P.2d at 938, 184 Cal. Rptr. at 716.

175. *Id.*

176. *Id.* at 57, 648 P.2d at 940, 184 Cal. Rptr. at 718.

177. *Id.* at 52, 648 P.2d at 937-38, 184 Cal. Rptr. at 716. The court had earlier sustained the two-thirds vote requirement on a constitutional challenge in *Amador*, 22 Cal. 3d at 237, 583 P.2d at 1294-95, 149 Cal. Rptr. at 253.

178. *Farrell*, 32 Cal. 3d at 58, 648 P.2d at 941, 184 Cal. Rptr. at 719 (Kaus, J.,

son, also dissenting, added that the decision allows local governments to replace the general revenue decline from property taxes with other general revenues free of any restriction from Proposition 13.[179] The dissenting justices could not reconcile the majority's view with the overall tax reform system of Proposition 13 when viewed in light of the purpose of section four.[180]

From the perspective of other states considering property tax reform, it does not really matter whether the majority or the dissenters were correct in *Farrell*. Either way, the case stands as a reminder to drafters of tax reform proposals to avoid ambiguity. The dispute resolved in *Farrell* came about only because the drafters of Proposition 13 failed to define the terms they used.

After *Farrell*, one issue regarding new revenue measures is clear. If a tax is a special tax, levied for a particular purpose, the two-thirds vote requirement of section four will apply; if a tax is a general tax, collected for general revenue purposes, section four does not regulate its adoption. Most published decisions, however, concern an entirely different issue: whether the revenue measure is a "tax" at all.

The latter issue first arose in *County of Fresno v. Malmstrom*,[181] regarding a special assessment Fresno County levied on property in a subdivision to construct improvements. The county tax collector refused to collect the money, arguing that the assessment constituted a special tax, and therefore required a two-thirds vote.[182]

Noting the ambiguous drafting of Proposition 13,[183] the California Court of Appeal drew a distinction between taxes and special assessments. "Taxes are raised for the general revenue of the governmental entity to pay [for] a variety of public services . . . . A special assessment is charged to real property to pay for benefits that property has received from a local improvement and, strictly speaking, is not a tax at all."[184] Rather than being a general revenue source, special assessments are "used to confer special benefit upon the parcels charged for the improvements . . . ."[185] The improvements to which the court referred included construction of "streets, sewers, sidewalks, water systems, lighting and public utility lines."[186] The court held that Proposition 13, as a measure reforming the system of ad valorem property taxes, does not regulate special assessments because they are not taxes.[187]

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dissenting).

179. *Id.* (Richardson, J., dissenting).

180. *Id.*

181. 94 Cal. App. 3d 974, 156 Cal. Rptr. 777 (1979).

182. *Id.* at 977-78, 156 Cal. Rptr. at 779.

183. *Id.* at 978-79, 156 Cal. Rptr. at 779.

184. *Id.* at 983-84, 156 Cal. Rptr. at 782-83 (citations omitted).

185. *Id.* at 983, 156 Cal. Rptr. at 782.

186. *Id.* at 978, 156 Cal. Rptr. at 779.

187. *Id.* at 980-82, 156 Cal. Rptr. at 780-82. As another court of appeal panel phrased it, "Special assessments, being levied only for improvements that benefit particular parcels of land, and not to raise general revenues, are simply not the type of exaction that can be

Therefore, a revenue device properly classified as a special assessment is not a tax and the section four requirement of a two-thirds vote will not apply. The key to defining a special assessment is the special benefit to certain property.[188]

The subsequent Court of Appeal decision in *Solvang Municipal Improvement District v. Board of Supervisors*[189] expanded on this concept. While adopting the reasoning of *Malmstrom*,[190] the court observed that, "[i]n practical application, the two types of taxation, general ad valorem taxes and special assessments, to some extent overlap, and we cannot always differentiate between them with precision."[191] The court listed as examples of traditional, appropriate special assessments "street improvement, lighting improvement, irrigation improvement, sewer connection, drainage improvement, or flood control improvement."[192] By contrast, levies to support fire and police protection, "and for general improvements, such as fire stations, police stations, and public buildings, which are deemed to benefit all property owners" would constitute taxes.[193]

The subtle distinction thus lies between special taxes on the one hand, which benefit the community generally and are subject to section four of Proposition 13, and special assessments on the other, which benefit specific property. Sensing that governments might try to use this subtlety to enact a traditional tax in the guise of a special assessment and thereby avoid Proposition 13, the court warned:

> We add a word of caution to taxing entities which might be tempted to use the special assessment exclusion as a means to circumvent the tax limitation of Article XIIIA. Our opinion excluding special assessments . . . from the one percent limitation of section 1 applies only to *true special assessments* designed to directly benefit the real property assessed and make it more valuable. Ordinarily, levies to meet general expenses of the taxing entity and to construct facilities to serve the general public, such as fire stations, police stations, and schools, may not be transformed from general ad valorem taxes to special assessments by a mere change in the name of the levy.[194]

Despite this cautionary note by the *Solvang* court, local governments have increasingly used special assessments to finance public improvements that tax revenues would probably have funded in years past. Between 1978 and 1980, use of special assessments increased by 175 percent.[195] For example, in *City of San Diego v. Holodnak*,[196] the Court of

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used as a mechanism for circumventing these tax relief provisions." County of Placer v. Corin, 113 Cal. App. 3d 443, 454, 170 Cal. Rptr. 232, 239 (1980).

188. *Malmstrom*, 94 Cal. App. 3d at 981, 156 Cal. Rptr. at 781.

189. 112 Cal. App. 3d 545, 169 Cal. Rptr. 391 (1980).

190. *Id.* at 554-55, 169 Cal. Rptr. at 397.

191. *Id.* at 553, 169 Cal. Rptr. at 396.

192. *Id.* at 552, 169 Cal. Rptr. at 395.

193. *Id.*

194. *Id.* at 557, 169 Cal. Rptr. at 398 (citations omitted; emphasis added).

195. *Special Assessments*, *supra* note 117, at 797 (citing ANNUAL REPORTS OF THE

Appeal allowed the City of San Diego to finance the construction of a public library branch, a park and ride facility, and a fire station through a special assessment.[197] The *Solvang* court specifically listed fire stations as facilities of general benefit and therefore not an appropriate object for special assessment financing.[198]

A variation on the special assessment theme has emerged in the increased use of development fees.[199] The basic idea behind development fees is that developers should pay to upgrade public facilities affected by new construction.[200] California courts have approved these fees to pay for increased transportation needs caused by new office space[201] and for schools necessitated by development of new subdivisions.[202] California

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STATE CONTROLLER, FINANCIAL TRANSACTIONS CONCERNING SPECIAL DISTRICTS (1980)).

196. 157 Cal. App. 3d 759, 203 Cal. Rptr. 797 (1984).

197. *Id.* at 762, 203 Cal. Rptr. at 799.

198. *Solvang*, 112 Cal. App. 3d at 557, 169 Cal. Rptr. at 398. A conflict of this type between Court of Appeal decisions can arise because the California Court of Appeal consists of six separate courts for different geographical districts, each composed of one or more divisions. CAL. GOV'T CODE §§ 69100-69106 (West. Supp. 1989). Cases are assigned to three-judge panels within those divisions. CAL. CONST. art. VI, § 3.

199. The increased use of development fees is documented in R. HECKART & T. DEAN, PROPOSITION 13 IN THE 1978 CALIFORNIA PRIMARY: A POST-ELECTION BIBLIOGRAPHY 90-91 (1981).

200. *See* Trent Meredith, Inc. v. City of Oxnard, 114 Cal. App. 3d 317, 325, 170 Cal. Rptr. 685, 689 (1981). That court reasoned that, "the developer has created a new, and cumulatively overwhelming, burden on local government facilities, and therefore he should offset the additional responsibilities required of the public agency by the dedication of land, construction of improvements, or payment of fees, all needed to provide improvements and services required by the new development." *Id.* at 325, 170 Cal. Rptr. at 689-90 (quoting LONGTIN, CALIFORNIA LAND USE REGULATIONS at 617 (1977)).

201. Russ Bldg. Partnership v. City and County of San Francisco, 199 Cal. App. 3d 1496, 1516, 246 Cal. Rptr. 21, 22 (1987). The California Supreme Court reviewed some aspects of the *Russ Bldg.* case, approving the retroactive application of the development fees to buildings under construction at the time the fee was instituted. Russ Bldg. Partnership v. City and County of San Francisco, 44 Cal. 3d 839, 854, 750 P.2d 324, 332-33, 244 Cal. Rptr. 682, 691 (1988). However, the court let stand the decision of the court of appeal as to the constitutionality under Proposition 13 of the fee itself. *Id.* at 845, 750 P.2d at 326, 244 Cal. Rptr. at 685.

202. *Trent Meredith*, 114 Cal. App. 3d at 327-28, 170 Cal. Rptr. at 691. Schools provide one of the clearest examples of a local service traditionally funded through taxes, rather than through assessments. The court based its reasoning largely on the notion that a property owner has no right to a building permit and therefore the government can attach whatever conditions it wants to the issuance of that permit. *Id.* at 325-28, 170 Cal. Rptr. at 689-91. The United States Supreme Court has specifically rejected this argument, stating, "[t]he right to build on one's own property . . . cannot remotely be described as a 'governmental benefit.'" Nollan v. California Coastal Comm'n, 107 S. Ct. 3141, 3146 n.2 (1987). The Court further held that, under the "takings" clause of the Fifth Amendment to the United States Constitution, the only conditions that government can attach to a building permit are those that would mitigate some impact of the development that would itself justify denial of the permit. *Id.* at 3147-48. For an excellent analysis of the *Nollan* decision, *see generally*, Bittle, *Nollan v. California Coastal Commission: You Can't Always Get What You Want, But Sometimes You Get What You Need*, 15 PEPPERDINE L. REV. 345 (1988).

statutes authorize the imposition of development fees for any purpose,[203] provided that the local government can prove that the development project creates the need for the public facility the fees would finance.[204]

Many local governments may find the prospect of financing public facilities through developer fees enticing, but should first consider the public policy implications of doing so. The government bears the burden of proving that the development project created the need for the facilities so financed.[205] These fees increase building costs, and therefore discourage development and increase housing costs.[206] Charges to the users of a service, in a non-governmental context, are simply called prices.[207] Developer fees may also entail other social costs, such as the inequity that arises if a few must pay for the facilities used by all. Legislatures should not make developer fees available to local governments simply as an alternative to the property tax without careful consideration of the types of programs to finance in this way.

Of late, California jurisdictions have begun attempts to raise revenue by assessing an annual fixed tax on every parcel of real estate.[208] Known as "parcel taxes," these taxes do not vary according to the value of the property.[209] Local governments find them appealing because, as non-ad valorem taxes, the one-percent limit of section one of Proposition 13 does not apply. Also, when levied for general revenue purposes, they do not require a two-thirds vote under section four of Proposition 13.[210] However, the attractiveness of parcel taxes to taxing entities results more from their perceived availability following Proposition 13's limitation on the ad valorem property tax, than on careful policy choices. It is difficult to imagine anyone favoring the reduction of ad valorem property taxes to replace them with flat fees on every parcel regardless of worth. The parcel tax places a proportionately greater burden on the owners of less valuable properties than on owners of more valuable properties.[211] The California Court of Appeal disapproved one such tax as a violation of the California Constitutional requirement that all property taxes must be ad valorem.[212] Some taxing authorities have, however, continued to attempt to impose

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203. CAL. GOV'T CODE §§ 66000-66009 (West Supp. 1989).

204. CAL. GOV'T CODE § 66001(a)(4) (West Supp. 1989).

205. Beaumont Investors v. Beaumont-Cherry Valley Water Dist., 165 Cal. App. 3d 227, 235, 211 Cal. Rptr. 567, 571 (1985).

206. HECKART & DEAN, *supra* note 199, at 90-91.

207. PROPOSITION 13, TEN YEARS LATER, *supra* note 116, at 13 (remarks of W. Douglas Morgan, Professor of Economics, University of California, Santa Barbara).

208. *See, e.g.*, City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988).

209. *Id.* at 103, 252 Cal. Rptr. at 99.

210. *Id.* at 104, 252 Cal. Rptr. at 101.

211. In *Digre*, the City of Oakland, in fact, argued that its tax was an excise tax on "the use and enjoyment of municipal services [as] a necessary incident of urban property ownership which may be taxed without taxing ownership per se." *Id.* at 107, 252 Cal. Rptr. at 103. The court rejected this argument, calling it a mere post hoc justification. *Id.*

212. *Id.* at 109, 252 Cal. Rptr. at 101 (citing CAL. CONST. art. XIII, § 1).

such taxes.[213]

Review of judicial interpretation of Proposition 13 reveals that property tax reformers failed to anticipate how ambiguities or omissions in the initiative might help defeat its purpose. Designers of a tax reform system must predict its consequences, and formulate clear policies as to whether and how to raise revenue. Policy makers should thoughtfully consider these decisions as part of an overall design of an equitable revenue system. The methods governments use to raise revenue should reflect sound policy choices, and should not amount simply to any opportunity remaining after the reform of the property tax.

IV. A Perspective for Tax Reform in Montana

California's experience demonstrates that tax reform is like squeezing a balloon: when reformers squeeze one part of the balloon by reducing a particular tax burden, natural forces of governmental expansion tend to create a bulge in the balloon somewhere else. The challenge for property tax reformers is to decide how far the balloon should expand, and the areas in which that expansion should occur. That means crafting careful policies regarding total revenue levels,[214] the preferred means of raising those revenues,[215] and the relationship between state and local govern-

213. For example, a California statute grants school districts authority to levy parcel taxes. Cal. Gov't Code § 50079 (West. Supp. 1989). For an example of such a tax, *see San Juan Tax Plan Opposed*, Sacramento Bee, Jan. 27, 1989, at B1, col. 4 (referring to a parcel tax proposed by the San Juan Unified School District in Sacramento County). The San Juan proposal, presented to the district's voters for approval on March 7, 1989, illustrates one problem with "ballot box budgeting." The district's presentation of the question on the ballot asked voters whether they would support a parcel tax to pay for various specific programs such as special education, reading, school libraries, and drug and alcohol abuse prevention. San Juan Unified School Dist. Res. No. 1546 (1988). However, the district adopted a contingency plan for budget cuts in case the voters rejected the tax. That plan contemplated cuts differed substantially from programs voters were asked to finance. *San Juan Swings Ax at Budget*, Sacramento Bee, Feb. 8, 1989, at B1, col. 5. Under ballot box budgeting, taxing entities can list their most popular programs on ballots in the hope of enticing voter support, rather than setting forth their actual priorities.

214. A limitation on property taxes to one percent of market value, similar to Proposition 13, would provide tax savings of between $47 million and $81 million annually, depending on how broadly that limit was applied to the various property classifications. Fiscal note to S.B. 158, at 1 51st Mont. Leg., Reg. Sess. (1989).

215. Montana has a long history of structuring its taxation system in ways that profoundly affect economic decision making. In the early part of this century, Montana's revenue structure shifted the burden of taxation onto individuals and farmers and away from "the Company." K. Toole, Montana: An Uncommon Land 221 (1959) (citing L. Levine, The Taxation of Mines in Montana (1920)). Beattie and Young have suggested that today the pendulum may have swung too far in the other direction, with the state opting for a "soak it to the rich and the corporations" philosophy. Beattie & Young, *supra* note 3, at 25. Perfect balance in the tax system must prove elusive because the more the system seeks to avoid one kind of error, such as giving big business a free ride, the more it risks another kind of error, such as discouraging business activity. *See* Radford, *Statistical Error and Legal Error*, 21 Loy. L.A.L. Rev. 843, 851 (1988). At the very least, Montana's plethora of property tax classifications and tax rates, *see supra* note 34, must affect economic decision making.

ments. Policy, and not availability, should control the selection of revenue sources.

This article does not propose which specific taxes or other funding sources policy makers should prefer when shifting tax burdens away from property taxpayers. Resolution of Montana's ongoing debates over a sales tax, the income tax surcharge, and severance taxes, to name but a few, lie well beyond the scope of this article. Rather, this article suggests ways of making alternative tax choices effective.

These suggestions begin with the observation that the recent Montana Supreme Court decision invalidating Montana's system of education finance affords an opportunity for a thorough review of the state's revenue structure. Succeeding sections demonstrate that once this review commences, legislators might choose one of two general approaches to reform, or a combination, with differing consequences. The legislature could grant local governments a share of state revenue, collecting any additional revenue at the state level. Alternatively, the state could authorize local governments to impose various new local revenue sources.

A. School Financing

The urgent necessity of restructuring the state's education finance system affords an opportunity for comprehensive review of the state's revenue structure. The legislature could find ways of channeling statewide non-property tax revenue into the educational system, providing property tax relief, and thereby incorporating the reform of education finance into the larger reform of the state's system of taxation.[216] Some proposals before the 1989 Montana Legislature instead advocated raising statewide property taxes to pay for equalization of education funding.[217] This approach would solve the immediate problem for the schools, but would ig-

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> Taxing different activities (in this case, assets) at different rates is tantamount to subsidizing one activity at the expense of another, which impacts resource allocation and ultimately lowers our standard of living . . . . Clearly our differential property tax system alters the relative costs of holding and using different kinds of property, which typically encourages inefficient and inappropriate production and consumption choices.

BEATTIE & YOUNG, *supra* note 3, at 25.

216. For example, during the 1989 regular session, Governor Stephens stressed the need for a permanent new source of school revenue and vowed to use his veto power to prevent increasing the burden of existing taxes. *Special Session Looms*, Missoulian, April 18, 1989, at 1, col. 3. Montana's sales tax controversy complicates this approach, with support for increasing property tax burdens resulting largely from opposition to the sales tax. As Representative Mike Kadas stated, "I know this is part of the whole sales tax game and I think we all know that." Missoulian, April 11, 1989, at C-1, col. 2. This article should not be construed as taking any position on the sales tax issue.

217. A proposal by Representative Mike Kadas would have increased the statewide mill levies for schools from 45 mills to 160 mills. H.B. 575, 51st Mont. Leg., Reg. Sess. (1989). Kadas acknowledged that this proposal would have increased property taxes for about half of the state's taxpayers. *Capitol Chronicle*, Missoulian, Feb. 12, 1989, at 12, col. 3. Presumably the other half would not have received increases because the proposal might have made some local permissive and voted levies unnecessary.

nore an opportunity to address overall revenue problems and might even increase the burden on property taxpayers.[218]

Recently, the Montana Supreme Court in *Helena Elementary School Dist. No. 1 v. State*,[219] mandated that the state's education system must provide equal opportunity to children throughout the state.[220] What this means in terms of precise levels of funding, including both state and local sources, remains unclear. A constitutional mandate for a particular level of funding is difficult to discern from the language of the constitution which provides, "It is the goal of the people to establish a system of education which will develop the full educational potential of each person. Equality of educational opportunity is guaranteed to each person of the state."[221] The first sentence, dealing with developing each person's full educational potential, states a goal, not a duty of the state. The second sentence relates only to equality of opportunity, not a level of opportunity.

The court implied that the inclusion in the constitution of an aspirational goal differs from language guaranteeing a right.[222] This decision did not determine what duty the state may have to pursue the goal expressed in the constitution. In an earlier decision, the court noted, "The legislature is obligated to provide a basic system of free quality education."[223] It therefore appears that the legislature must *equalize* educational opportunity throughout the state, as well as provide a public school system that meets some imprecise basic *level* of quality.

Several passages from the court's decision may suggest to some that merely distributing current revenues equally statewide may not provide sufficient funding. Such a conclusion may read more into the court's decision than the holding actually merits. While the court rejected the idea that sufficient funding to meet minimum accreditation standards would suffice[224] and criticized the state's failure to adequately fund its statewide foundation program,[225] increased state funding for poorer districts might make some local property tax levies unnecessary. The decision therefore does not indicate whether the constitution mandates a higher total level of funding for education, including both state and local revenue. Because the framers of the constitution chose to express their only reference to

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218. Anticipating the rejection of H.B. 575 by a select committee, House Daily Status Report, April 24, 1989, at 36, Representative Kadas moved to amend a competing bill, S.B. 203, 51st. Mont. Leg., Reg. Sess. (1989), to increase by 25 mills the statewide property tax levy proposed in that bill. Missoulian, April 11, 1989, at C-1, col. 2 (profiling Representative Kadas).

219. ___ Mont. ___, 769 P.2d 684 (1989).

220. *Id.* at ___, 769 P.2d at 690.

221. MONT. CONST. art. X, § 1.

222. *Helena School Dist.*, ___ Mont. at ___, 769 P.2d at 689.

223. State *ex rel.* Bartmess v. Board of Trustees, ___ Mont. ___, ___, 726 P.2d 801, 804 (1986) (citing MONT. CONST. art. X, § 1).

224. *Helena School Dist.*, ___ Mont. at ___, 769 P.2d at 691.

225. *Id.* at ___, 769 P.2d at 690.

level of educational opportunity as an aspirational goal,[226] the legislature must have broad discretion to decide what level of funding adequately advances that goal. To conclude otherwise would seriously jeopardize the separation of powers by enmeshing the courts too deeply in the budget and taxation process.[227]

The supreme court's decision also leaves unanswered an intriguing question regarding the future availability of local voted school levies. The decision's entire theme revolves around the principle of *equal* educational opportunity.[228] The court based its conclusion partly on the "excessive reliance on . . . voted levies . . . ."[229] The decision must therefore call into question the ability of wealthy districts to impose additional taxes upon themselves to augment local educational programs. A system allowing this option may perpetuate the disparities between rich and poor districts.

The availability of local voted levies might even encourage relatively low statewide education budgets. This largely speculative concern stems from the assumption that the state's budget in the current economic climate very nearly resembles a zero-sum game in which the appropriation of more money for one purpose necessarily means that less must be appropriated for some other. Legislators might be inclined to appropriate scarce state dollars to other high priority purposes[230] if local communities which wish to do so may supplement their school district budgets with locally voted levies. This might work to the detriment of children in poorer communities whose parents lack the realistic option of matching other communities' voted levies. On the other hand, the tight state budget might suggest a greater need to find ways for communities, or even individual parents, who want to provide greater opportunities for their children to have a vehicle for doing so. While the option for local communities to supplement the educational opportunities of their children through local voted levies holds much attraction, its exercise may conflict with the constitution's dictate of equal educational opportunity for all.

Resolution of the many issues involved in restructuring education finance offers an unparalleled opportunity to review Montana's entire reve-

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226. MONT. CONST. art. X, § 1 (first sentence).

227. *See* Comment, *Butte Community Union v. Lewis: A New Constitutional Standard for Evaluating General Assistance Legislation*, 48 MONT. L. REV. 163, 176 (1987) (authored by Scott C. Wurster). Even if the current total level of funding satisfies the constitution, overall increases may occur if the legislature, and ultimately the public, reject budgetary reductions for the wealthier districts.

228. *Helena School Dist.*, ___ Mont. at ___, 769 P.2d at 690.

229. *Id.*

230. In 1988, California voters adopted an initiative measure designed to guarantee public schools a minimum percentage of the state's general fund budget. Proposition 98, § 5, *reprinted in* CALIFORNIA BALLOT PAMPHLET, GENERAL ELECTION, at 79 (1988) (amending CAL. CONST. art. XVI, § 8). While the goal of seeking adequate funding for education is laudable, the removal of California's elected officials from the establishment of priorities for the spending of public money must cause concern.

nue structure.[231] The legislature should not overlook this occasion to reform Montana's system of taxation.

B. *Providing State Revenue for Local Governments*

Two major concerns would result from a decision to replace local property taxes with state revenue. First, the legislature should structure its reform to preserve local control over local decision-making. Second, the reform should insure that new statewide revenue sources do not cause overall tax burdens to increase, unless such an increase results from a conscious policy choice.

As discussed previously, California has experienced a decline in local autonomy as a result of local government's dependence upon the state for revenues.[232] Montana should prevent this development by requiring that any state assistance to local governments come in the form of block grants. State requirements for the spending of local budgets lead to a loss of local control.

As a counterpart to providing local assistance in the form of block grants, Montana should study the effectiveness of its statutes requiring the state to pay for services it mandates local governments to provide.[233] Local governments consistently complain that the legislature requires localities to provide certain services, but does not provide funding.[234] Should a legislative study prove this point, California's experience suggests that enacting a constitutional provision requiring state funding of mandated local programs may improve the situation.[235]

If the legislature decides to provide assistance to local governments through funds collected at the state level, it will have to determine on a policy basis what sources to use in collecting that revenue. To the extent

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231. The legislature should use the opportunity of school finance reform to review the basic premises underlying the property tax system. For example, property taxes bear little relation to ability to pay or to burdens placed on public services. BEATTIE & YOUNG, *supra* note 3, at 7. The current practice of assessing property based on its highest and best use, rather than current use, exacerbates this problem. *See supra* text accompanying notes 30-31. The legislature should consider assessing property based only on current use, rather than taxing the unrealized potential for the property to produce greater wealth for its owner. Such a change would reflect a shift from viewing the property tax as purely a tax on wealth, often as a paper or hypothetical concept, to a tax more closely related to ability to pay.

The economic effects of such a change in policy would require study. Taxation based only on current use may provide greater relief to development interests than to ordinary home owners because studies might (or might not) determine that most property not currently utilized at its highest and best use is held for development or investment purposes. It might also marginally affect the pace at which development takes place.

232. *See supra* text accompanying notes 147-59.

233. MONT. CODE ANN. § 1-2-112 (1987) (local governments); MONT. CODE ANN. § 1-2-113 (1987) (school districts).

234. WE THE PEOPLE, *supra* note 21 at 234. This pattern continued in the 1989 regular session of the legislature, which rejected a bill which would have dramatically increased the taxing authority of local governments. H.B. 479, 51st Mont. Leg., Reg. Sess. (1989).

235. *See supra* text accompanying notes 153-57.

that such sources may entail creating new taxes,[236] the concern arises that proliferation of the number of taxes may ultimately lead to higher overall tax burdens. While the legislature may create new taxes for the sole purpose of decreasing property taxes, resulting in a more equitable tax system, nothing would prevent future increases in those taxes. The taxpayer could lose in the long run if a proliferation of taxes results not in tax reform but in a larger number of taxes with the potential for future increases.

In order to alleviate that problem, and simultaneously to make creation of a new revenue source more politically palatable, the legislature and voters might consider a constitutional amendment limiting the imposition of new taxes to the amount necessitated by property tax reductions. The amendment could do this by limiting the amount collected from a new tax, dollar for dollar, to the amount of revenue forgone through property tax reductions. Such an amendment could either limit taxes from a particular source, such as a sales tax or income tax increase, or more broadly limit all tax increases. To account for the legitimate governmental needs for increases in revenue over time, the constitutional amendment could index taxes to such factors as population growth, cost of living, economic growth, or other factors.[237] The amendment could link tax increases to tax reform as broadly or as narrowly as desired.

Alternatively, the legislature could authorize additional revenue sources, but require voter approval for new taxes or tax increases.[238] This approach differs from a limit on tax increases by accepting the possibility of significant tax increases, but providing voters with control over those increases.

C. *Local Revenue Sources and Property Tax Reform*

Authorization of new local revenue sources may accompany property tax reductions so that property tax reform becomes meaningful. Such a

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236. For example, a bill rejected by the 1989 Legislature would have placed a three percent sales tax before the voters. S.B. 456, 51st Mont. Leg. Reg. Sess., § 135 (1989). The bill also proposed a slight cut in property tax revenue, *Id.* at § 100, an allocation of sales tax revenue to make up for that decrease, *Id.* at § 73, and an increase in state education funding, *Id.* The fiscal note to S.B. 456, however, indicated that the bill would reduce property taxes by only 2.9% in fiscal year 1991. Fiscal note to S.B. 456, 51st Mont. Leg., Reg. Sess., at 2 (1989).

237. CAL. CONST. art. XIIIB, § 1, may provide a model for such an indexing formula. It allows California's state spending limit to increase annually to reflect growth in population and in the cost of living. The precise formulation of such a system would require careful economic analysis.

238. A proposed constitutional amendment rejected by the 1989 Montana Legislature promoted this approach. The amendment would have required voter approval for a new or increased sales tax, both at the state and local levels, required legislative authorization for a local sales tax, and allowed the voters to reduce or abolish state or local sales taxes by initiative or referendum. H.B. 269, 51st Mont. Leg., Reg. Sess. (1989). A failed sales tax bill would also have required voter approval for its enactment or any subsequent increase. S.B. 456, 51st Mont. Leg., Reg. Sess., §§ 134, 135 (1989).

solution would not impinge upon local autonomy, because local governments would lose discretionary income only to the extent that tax reform would accomplish a net tax decrease.

This approach to tax reform should take into account the desired amount of local government revenue and the preferred sources for that revenue. Under current Montana law, counties may impose only those taxes specifically authorized by statute.[239] Municipalities also require specific statutory authorization to levy a tax,[240] but may freely impose special assessments "reasonably related to the cost of any special service or special benefit provided by the municipality [or they may] impose a fee for the provision of a service."[241] Local governments with self-government charters are not subject to statutory mill levy limits,[242] and may impose any tax they choose except for a local income tax or sales tax.[243]

To be effective, a plan for property tax reform preserving local autonomy should not result in greater increases in other taxes than desired. The legislature could address this concern in either of two ways. First, the legislature could simply authorize greater discretion to localities without self-government charters in imposing taxes. This authorization would allow each local government to choose the revenue source it prefers and the amount of revenue to be raised. This approach would entrust each locality with its own policy choices as to the extent and source of new revenue, but would provide no statewide guarantee that total tax burdens would not increase. A variation on this approach might require voter approval for some or all new or increased taxes.

A second approach would entail policy determinations by the legislature as to the varieties and levels of local taxes. The legislature could authorize local governments to levy only specific taxes, and could limit the amount of those taxes. Such a policy should also address the issue of self-governing localities. The legislature could decide to allow greater discretion to localities with self-government charters, as under the first approach, but specify the type and size of new taxes in other localities. Alternatively, the legislature could apply statewide policies to all localities.[244] The legislature has traditionally declined to provide local governments, other than self-governing localities, with broad authorizations to raise revenue, preferring to keep such policies tightly controlled by state government.[245]

Policy makers should examine Montana's special assessment laws with a view toward assuring that they do not provide an avenue for the circumvention of property tax reform. Montana law currently authorizes

239. MONT. CODE ANN. § 7-1-2103(5) (1987).
240. MONT. CODE ANN. § 7-1-4123(5) (1987).
241. MONT. CODE ANN. § 7-1-4123(7) (1987).
242. MONT. CODE ANN. § 7-1-114(1)(g) (1987).
243. MONT. CODE ANN. § 7-1-112(1) (1987).
244. The Montana Constitution provides that self-governing localities "may exercise any power not prohibited by this constitution, law, or charter." MONT. CONST. art. XI, § 6.
245. WE THE PEOPLE, *supra* note 21, at 234.

special assessments for specific purposes through the creation of special districts.[246] Municipalities, whether self-governing or not, may also impose assessments or fees wherever they can establish a reasonable relation between the assessment or fee and some government service or benefit.[247] Such broad authorizations might undermine the goals of property tax reform by encouraging the use of special assessments to evade property tax limits.

Like California, Montana law recognizes a distinction between taxes and assessments. As the Montana Supreme Court explained, "A tax is levied for the general public good . . . . An assessment is imposed against specific property to defray the cost of a specific benefit to that property, the benefit to be commensurate with the assessment."[248] The legislature should consider restricting such assessments to appropriate purposes. Creative minds might envision specific benefits to property from a variety of services traditionally funded through taxes. These services might include police and fire protection,[249] ambulance service,[250] libraries,[251] and even television facilities.[252] Policy makers need to face the policy choice of whether to allow financing of such services through assessments, outside of any limitations on taxes, or whether to limit special assessments to the traditional uses of constructing such public improvements as lighting, sewers, sidewalks, and streets.

The Montana legislature should thoroughly consider all ramifications of property tax reform. Property tax cuts may render necessary additional sources of local revenue. Policy, and not mere availability, must dictate choices for sources of revenue. Finally, the public should not face greater tax burdens than informed public policy dictates.

V. CONCLUSION

Montana imposes one of the heaviest burdens in the nation on its property taxpayers, even though that tax may bear little relation to ability to pay. Montana voters have made clear their demand that property taxes be lowered and that the legislature take appropriate actions to insure the funding of essential local services following that reduction. The

246. Montana's special assessment statutes regarding improvement districts are codified in Chapter 12 of Title 7 of the Montana Code Annotated (1987).

247. MONT. CODE ANN. § 7-1-4123(7) (1987).

248. Vail v. Custer County, 132 Mont. 205, 217, 315 P.2d 993, 1000 (1957). *See also*, Stevens v. City of Missoula, 205 Mont. 274, 280, 667 P.2d 440, 444 (1983); Crutchfield v. Nash, 84 Mont. 556, 564, 276 P. 938, 941 (1929); Power v. City of Helena, 43 Mont. 336, 341, 116 P. 415, 416 (1911).

249. *See* CAL. GOV'T CODE § 25210.4(a), (b) (West Supp. 1989). *But see Special Assessments*, *supra* note 117, at 806-14 (concluding that assessments for police and fire services are special taxes, and not special assessments, within the meaning of Proposition 13, and therefore require a two-thirds vote for implementation).

250. *See* CAL. GOV'T CODE § 25210.4a(8) (West Supp. 1989).

251. *See* CAL. GOV'T CODE § 25210.4(e) (West Supp. 1989).

252. CAL. GOV'T CODE § 25210.4(f) (West 1988).

Montana Legislature should respond to this call by reducing property taxes.

At the same time, Montana can profit from California's experience with tax reform and heed its lessons on how to make tax reform effective. A tax reform effort must predict adequately the consequences of that reform. The legislature should set policies as to the extent of new revenue needed and the preferred methods of raising that revenue. The menu of tax options available to government should allow for a balance of revenue sources. Montana's tax system should not permit excessive taxation; nor should it force reliance on a single revenue source simply because government lacks other options.